Supreme Court, U.S.
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No. 94-

In the Supreme Court

OF THE

UNITED STATES

OCTOBER TERM 1994

ESTATE OF SILVIO RAVETTI
Petitioner,

Vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

I. DOES THE OTHER SPOUSE HAVE A RIGHT TO JUDICIAL REVIEW OVER THE GRANTING OF INNOCENT SPOUSE STATUS UNDER §6013(E) OF THE INTERNAL REVENUE CODE?

II. IS THE OTHER SPOUSE AN INDISPENSABLE PARTY IN TAX COURT LITIGATION CONCERNING §6013(E) OF THE INTERNAL REVENUE CODE?

III. IN ADJUDICATING FRANK LYON SHAM LOSS DEDUCTIONS COULD MOTIVATION BE DETERMINED AT THE PARTNERSHIP LEVEL BEFORE TEFRA?

IV. MUST THE INTERNAL REVENUE SERVICE COME FORWARD WITH EVIDENCE OR A FINDING IN THE STATUTORY NOTICE TO FIND THAT THE GENERAL PARTNER HAS FRANK LYON SHAM MOTIVATION?

V. ARE AGREEMENTS BETWEEN TAXPAYERS AND THE INTERNAL REVENUE SERVICE GOVERNED BY THE GENERAL CONTRACT LAW OF MISTAKE AND CAPACITY TO CONTRACT ?

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OPINIONS BELOW

The opinion of the Court of Appeals in #93-70852 was not published. It is attached as Appendix A. In this docket number the order of the Tax Court with respect to the innocent spouse issue was published as TCM 1989-45, it is attached as Appendix B. The opinion on the merits was published as TCM 1993-343, it is

attached as Appendix C.

The opinion of the Court of Appeals in #93-70851 was not published, it is attached as Appendix D. The order of the Tax Court refusing to grant relief from collection under Tax Court Rule 55 is attached as Appendix E. The opinion of the Tax Court on the merits was published as TCM. 1993-418, It is attached as Appendix F.

JURISDICTION

The decisions of the Court of Appeals were entered on October 11, 1995. Justice O'Connor as Circuit Justice extended the time for filing this petition until February 8, 1995. This Courts jurisdiction in invoked under 28 USC 1254.

Jurisdiction was conferred below by 26 USC 7442.

STATUTORY PROVISIONS INVOLVED

Section 6013(e) - INNOCENT SPOUSE STATUTE

(e) Spouse Relieved of Liability in Certain Cases.---

(1) In general.---Under regulations prescribed by the Secretary if---

(A) a joint return has been made under this section for a taxable year,

(B) on such return there is a substantial understatement of tax attributable to grossly erroneous items of one spouse,

(C) the other spouse establishes that in signing the return he or she did

not know, and had no reason to know, that there was such substantial understatement, and

(D) taking into account all the facts and circumstances, it is inequitable to hold the other spouse liable for the deficiency in tax for such taxable year attributable to such substantial understatement. .....

TRANSITIONAL RULE
Section 6013(e), INNOCENT SPOUSE STATUTE

26 Section 6013

1984 Act. Section 424(c) of Pub. L. 98-369, Div. A as amended by Pub. L. 100-647, Section 6004, Nov. 10, 1988, 102 Stat. 3685, provided that :

(1) In general.---Except as provided in paragraph (2), the amendments made by subsections (a) and (b) [amending subsec. (e) of this section and enacting section 66(b), (c), redesignating as section 66(d) former (66(b), and amending headings of section 66 and 66(a) of this title] shall apply to all taxable years to which the Internal Revenue Code of 1954 applies. Corresponding provisions shall be deemed to be included in the Internal Revenue Code of 1939 and shall apply to all taxable years to which such Code applies.

"(2) Authority to disregard community property laws.--- Subsection (b) of section 66 of the Internal Revenue Code of 1954, as added by subsection (b) [section 66(b) of this title], shall apply to the taxable years beginning after December 31, 1984."

"(3) Transitional rule.---If---

"(A) a joint return under section 6013 of the Internal Revenue Code of 1954 [this section] was filed before January 1, 1985,

"(B) on such return there is an understatement (as defined in section 6661(b)(2)(A) of such Code [section 6661(b)(2)(A) of this title] which is attributable to disallowed deductions attributable to activities of one spouse,

"(C) the amount of such disallowed deductions exceeds the taxable income shown on such return,

"(D) without regard to any determination before October 21, 1988, the other spouse establishes that in signing the return he or she did not know, and had no reason to know, that there was such an understatement, and

"(E) the marriage between such spouses terminated and immediately after such termination the net worth of the other spouse was less than $10,000,

notwithstanding any law or rule of law (including res judicata), the other spouse shall be relieved of liability for tax (including interest, penalties, and other amounts) for such taxable year to the extent such liability is attributable to such understatement, and, to the extent the liability so attributable has been collected from such other spouse, it shall be refunded or credited to such other spouse. No credit or refund shall be made under the preceding sentence unless claim therefore has been submitted to the Secretary of the Treasury or his delegate before the date 1 year after the date of the enactment of this paragraph [No. 10, 1988], and no interest on such

credit or refund shall be allowed for any period before such date of enactment."

STATEMENT OF THE CASE

This Petition relates to separate appeals from the Tax Court on petitions for redetermination covering different taxable years for the same taxpayer. The Court of Appeals ordered them calendared together with the case of the same taxpayer verses the United States. They were assigned to the same panel of the Court which declined to hear oral argument and decided all cases the same day, October 11, 1994. CA # 93-70852 concerns the tax years 1976,1977, and 1978. CA #93-70852 concerns the tax year 1982. The years 1979, 1980, and 1981 are now before the Ninth Circuit on appeal from two separate Tax Court decisions.

All of the tax years except 1982 involve the innocent spouse judicial review issue which is before this Court by separate petition in Estate of Ravetti v United States.

The cases which are the subject of this petition both concern the substantive tax issues involved in this litigation. They both have some of the same questions presented for review. Since they were at least partially consolidated by the Court of Appeals, we thought it appropriate to join them in this petition.

As was indicated in the companion petition before this Court, the Taxpayer

and his wife filed joint income tax returns for the years 1976 - 1981. After audits the Internal Revenue Service issued joint deficiency notices for all years. They were divorced in 1982, and Mrs Ravetti received over a half million dollars in the property settlement. They filed separate petitions in the Tax Court. No notice of the wife's petition was given or required by the Tax Court rules to be given to the Taxpayer by her attorney.

Without notice to Petitioner, although notice was requested, and without an opportunity to be heard the Internal Revenue Service stipulated for the tax years 1976-1981, in three separate dockets, that Mrs. Ravetti was an innocent spouse under the provisions of 6013(e) if the Code. The Tax Court then issued a decision relieving her from any liability for the tax deficiencies in question. As we indicated in the District Court petition, as a matter of law she was not entitled to this status. Among other things, her net worth exceeded $10,000 and this disqualified her under the Transitional Rules to the amended innocent spouse statute.

We have raised the basic question of procedural due process involved in these proceedings in the companion case Estate of Ravetti v United States, and we will not cover the same ground here. In this case we discuss the fundamental question of whether in circumstances such as this the other spouse is an indispensable party to litigation relieving federal tax liability under §6013(e) in the Tax

Court.

Although CA #70852 and CA #70851 share common questions of law, and neither involved oral testimony, they had different procedural histories. CA #70851 was decided on summary judgment, and CA#70852 on stipulated facts submitted under Tax Court Rule 122. Each docket involved the disallowance of different partnership losses, but the disallowance of each was on the basis that the intent of the general partner could be imputed to the taxpayer before the partnership tax rules were enacted by Congress in 1982. Both cases also involve a disregard of basic contract law principles in agreements between the Internal Revenue Service and the tax payers by both the Tax Court and the Court of Appeals.

The Taxpayer had "presenile dementia" and was confined in a mental hospital in November and December of 1980. The questioned waiver of the statute of limitations was in April of 1981. The stipulated statement of the treating physician established the condition existed in all the tax years before the Court. He was declared incompetent by the California Courts in 1985 and died of Alzheimer's disease in 1986.

CA #70852 concerned the tax years 1976-78. Two investments were disallowed as shams under the rules of Frank Lyon Co. v United States 435 U. S. 561; 98 S.Ct 1291 (1978). One involved coal limited partnerships and individual coal

lease investments, and the other was an investment in a movie.

The promoter and general partner in the coal cases was a thief. He was indited for security fraud in connection with these transaction. In the Ninth Circuit decision in U. S v Crooks (9th Cir) 884 F2d 1441 he was described as a check kiter who did not have coal leases at all. In the movie investment which had an all star cast including John Carradine, Kurt Jurgens, and Peter Graves the general partner was not identified. The cast were paid on a contingent basis, Unfortunately, there was a loss.

Both the Tax Court and the Ninth Circuit held that the intent of the general partner controlled for the purpose of determining whether the transaction was motivated by economic substance outside of tax considerations, and in neither investment had the Taxpayer proved that the general partner was not solely motivated by tax considerations. However, the Tax Court in CA# 93-70852 refused to penalize the Taxpayer for a tax motivated transaction on the grounds that the Service had failed to prove it.

The statute of limitations would bar liability in CA93-70852 unless a valid waiver was executed by the Taxpayer. Since the stipulated statement of the treating physician established that he was suffering from dementia, under well established contract principles no valid waiver could have been executed, since the Taxpayer was incompetent to execute

one.

CA# 9370851 involves the bizarre situation of collection before trial in a docketed Tax Court case in violation of §6213(a). The issue involves a stipulation between I. R. S. District Counsel and the Attorney for the Taxpayer. In that connection Counsel wrote the attorney for the service agreeing to stipulate to the merits of the oil investment, but reserving the right to defend on the basis of the special defenses unique to the Taxpayer as follows:

> These defenses which in the main involve the late Mr. Ravetti's mental incompetency include the statute of limitations, profit motivation, imputed intent before TEFRA, theft loss deductions and the innocent spouse issue which is presently before the Ninth Circuit."

The stipulation between attorneys allowed special defenses, did not mention a dollar amount, and did not contain any reference to a waiver of restrictions on collection. However, in a purportedly parallel document to be signed by the petitioner a waiver was included in the other stipulations executed by the lawyers. After collection effort commenced, Mr. Kinghofer the district counsel involved was contacted and advised that the waiver had been included by mistake.

However, higher authority in the Service refused to modify the agreement.

Petitioner then rescinded the stipulation on which the judgment of the Tax Court is based. After a motion under Tax Court Rule 55 to restrain collection, the Tax Court and the Ninth Circuit held that this agreement was written in stone, and refused to allow the recision.

In its motion for summary judgment the Service introduced no facts except the stipulation. It did not identify the general partner. No finding was made with respect to the partnership and the general partner was not even identified in the statutory notice. The Ninth Circuit held the burden was on the Petitioner to prove that the investment was not solely tax motivated at the general partner level, and the Taxpayer's motivation was immaterial.

We realize this is a petition for certiorari and the Court is not in the main concerned with the justice of the petitioners treatment below, but we cannot help but comment on the sorry treatment this taxpayer received below, both judicially and administratively.

The first petition to the Tax Court in this matter was filed in 1982. The Tax years date back to 1976, almost twenty years ago. The Taxpayer is dead, as is his ex wife, as are most of the potential witnesses. No continuance was ever granted the Petitioner, and motions to consolidate the cases by Petitioner were denied three times. Facts stipulated in one case are ignored in the other. For example, the principle ground for rejecting the stipulated fact that

Ravetti was demented in the first Tax Court case was the absence of the raw medical records. These records are included in the second case. In regard to a theft deduction for the coal investment promoters the IRS refused to name a year of discovery, despite the fact that audits, indictments, and convictions all took place within the period from 1976 to 1982 all of whose tax years were before the Tax Court in one docket or another. In one of the Tax Court dockets still before the Ninth Circuit there is a stipulation which establishes that the Service was informed of Ravetti's alzheimer's disease before waivers of the statute of limitation were executed. This information was disregarded by the service.

Counsel for the Service at one time totaled seven, and stretched geographically from Idaho to Los Angeles, and a number of points in between. This Court will note at least four different Judges in the Tax Court on in the opinions supplied in the Petitions. There were at least four more.

All this took place because what the Tax Court and the Service calls "special projects" were involved. This caused, because they overlapped years, multiple government counsel in the same case. It probably led, because of the form documents involved, to the mistake which caused premature collection. In denying the normal right to try related cases together, the Court allowed the Service to ignore in one docket facts stipulated in the other.

Below we raised the question whether refusing to consolidate these cases was such a depravation of substantive right as to require reversal. We would not presume to ask for Supreme Court review on such a ground. However, if review is granted on grounds of more national importance, perhaps, the rights of this taxpayers estate could be taken into account in the future disposition of the case.

REASONS FOR GRANTING THE WRIT

The principal ground for granting the writ is the denial of meaningful judicial review by granting innocent spouse status without allowing the person most directly concerned to object. Estate of Ravetti v U. S. represents the attempt to obtain review in the District Court, this case deals with an attempt in the Tax Court. Having both cases before the Court gives a unique opportunity to examine the problem from both planes of reference.

Each Court has problems in dealing with this question. The Tax Court with Comm. v Gooch 64 S. CT 184 and the District Court with the Anti Injunction Act. We submit, however, that there must be federal judicial review in one of them on this question of federal tax law to satisfy the Constitution. The national importance of this question is self evident, and for this Court as with the Court below the case is one of first impression.

The merits of these cases should be considered also. These cases arose before TEFRA, and the effective date of the regulation implementing the assigning of profit motivation to the partnership level. Furthermore, imputing a motivation which forfeits even "at risk" deductions to a taxpayer when the check kiting promoter general partner obtained their money by fraudulent misrepresentation defies common sense.

The refusal of the Tax Court and the Court of Appeals to apply the basic contract principles of mistake and capacity to contract in agreements between taxpayers and the Internal Revenue Service should be reviewed. In this connection these cases are in direct conflict with the case of Flynn v U. S.(3Cir) 786 F2d 586(1986). In both administrative law and when the federal courts are directly involve, attorneys should be able to trust government agencies not to take advantage of mistakes which while they benefit the government were not in the contemplation of the parties. Nor should they be allowed greater latitude in dealing with incompetents than private individuals. While this Court has upheld and stated these principles many times, the importance of the sanctity of agreements between citizens and their government requires constant admonition from this Court. Of the many duties of the Supreme Court, this one may be the most important.

1. THE TAX COURT SHOULD HOLD THE OTHER SPOUSE AN INDISPENSABLE PARTY IN

LITIGATION CONCERNING §6013(e)

In the 1855 case of Shields v Barrow 58 U.S. 130, long before the rule was codified in Rule 19 of the Federal Rules of Civil Procedure, this Court defined indispensable parties for the purposes of federal litigation.

> "Persons who not only have an interest in the controversy, but an interest of such a nature that a final decree cannot be made without either affecting that interest or leaving the controversy in such a condition that its final determination may be wholly inconsistent with equity and good conscience."

This principle was not limited to what was then the equity side of the courts. Barney v Baltimore City 73 U. S. 280 (1867); See Federal Practice and Procedure, Wright et al §1601. It may well be that in Tax Court litigation the requirement in cases of this nature is so fundamental as to be a requirement of due process, regardless of equity powers.

A joint return is unique, not to speak of the association of man and wife. Partnership returns are simply conduits. In the other situations cited below the taxpayer affected has a right of federal judicial review of his own case. Here, as a practical matter Mrs. Ravetti's status has been finally adjudicated. Questioning that status in state court without congressional action conferring state court jurisdiction would be useless.

The Government could have joined the cases under Tax Court Rule 60, but chose not to do so. In "good conscience" the Tax Court could have required them to do so. It could have done so by adjudicating the right in Petitioner's case. Furthermore, disregarding our inquiry was not fair or proper of government counsel.

We recognize that some might argue that this would be the exercise of the equity power. However, splitting jurisdiction with the District Court has other serious problems, including the inhibitions on tax jurisdiction discussed by Judge Jensen in the District Court. In Flora v U. S 362 U.S. 145, 80 SCt 630, 4 L.ed 2d 625 (1960) this Court emphasized that in income tax matters it was the intent of Congress to give as broad a jurisdiction as possible in preference to the exercise of jurisdiction in the District Court. In Laing v U.S 423 US 161, 46 LEd2d 416 96 SCt 473 the Court also said that it is not to be presumed that Congress did not in tax matters intend the Tax Court not to have jurisdiction. Only the Supreme Court has the power of court supervision to find the proper answer, and it should do so.

2. THE LOWER COURTS HAVE MISAPPLIED FRANK LYON IN ADJUDICATING ALLEGED SHAM LOSS DEDUCTIONS

The investment losses in the Tax Court cases were all disallowed as shams under the rule of Frank Lyon supra. This rule involves a two part test. That is, a transaction is a sham if (1) it is not motivated by any economic substance

outside of tax considerations and (2) is without economic substance because no real potential for profit exists.

The consequence of disallowance on this ground is that a taxpayer loses his deduction not only for those amounts which were not at risk, unassumed mortgage depreciation and the like, but all amounts which were "at risk" including his out of pocket cash payments. In a practical way this amounts to a penalty or forfeiture without the burden of proof required in fraud cases.

We question in this petition the lower Courts' interpretation of the burden of coming forward with evidence, and the burden of proof in Frank Lyon sham cases. We also question whether the motivation of the general partner instead of the taxpayer should be considered by the courts in such cases. Particularly, before the effective date of TEFRA.

a) IMPUTING THE INTENT OF THE GENERAL PARTNER TO THE TAXPAYER BEFORE TEFRA IS IMPROPER

The Ninth Circuit in imputing the general partners intent to the taxpayer relied on the Tax Court's case of Hawley v Comm. TC Memo 1988-77 and its own cases Independent Electrical v Comm. (9 cir) 781 F.2d 728. These are part of a series of cases commencing in the early eighties that first the Tax Court and the then the Courts of Appeals began disregarding the motivation of the taxpayer and deciding that the motivation of the promoter, general partner should control in

declaring an investment a sham. (Although most cases at least made an attempt to set forth evidence that the taxpayer had similar tax avoidance ideas.)

In this case the matter was taken to extremes since the promoter general partner was a thief and the taxpayer was incompetent. These rulings had the commendable aim of controlling abusive tax shelters, however there was no statutory warrant for doing so until the enactment of TEFRA in 1982.

The actual statute applicable to our case is §6231 (a) (3) which reads as follows:

> **Partnership item**--The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partners level. Emphasis added

The regulation necessary to implement the statute is §301.6231(b) which reads as follows:

> **(b) Factors that affect the determination of partnership items.** The term "partnership item" includes the accounting practices and the legal and factual determinations that

> underlie the determination of the amount, timing and characterization of items of income, credit , gain, loss, deduction, etc Examples of these determinations are:.....whether partnership activities have been engaged in with the intent to make a profit.....Emphasis added

The statute was enacted in 1982 and the regulation in 1986. Regulation §301.6231(d) of the regulation provides that "This section shall apply with respect to partnership taxable years beginning after September 3, 1982." Our years are 1976,1977,1978 and 1982.

Taxation is a creature of statute and adjudicating profit motivation at the partnership level was not authorized for our years. The report of the conference committee makes clear that the Congress thought it was changing the law when it adopted this statute in TEFRA. The wide spread use of this doctrine without congressional sanction should be reviewed. Particularly, where the general partner was a thief, his intent should not be attributed to the demented incompetent taxpayer. Congress has provided in §465 and other sections adequate control of abusive tax shelters, some which apply to these years.

b) THE BURDEN IS ON IRS TO COME FORWARD WITH EVIDENCE OR AT LEAST A STATUTORY NOTICE FINDING THAT THE GENERAL PARTNER HAD FRANK LYON MOTIVATION

In none of the three partnerships whose losses were disallowed was there a finding as to the motivation of the general partner in the statutory notice. In the movie and the oil partnership the general partner was not even identified. The Court below simply held that the burden was on the taxpayer to identify and prove the general partners intent was not to avoid taxes. In other words, the taxpayer must prove a negative, and mere accusation by issuing a statutory notice with a dollar amount, casts the burden on the taxpayer to come forward with evidence which shows the Tax Court and the Service were " clearly in error".

This would not seem to be in accord with this Court's ruling on a similar issue in Comm. v Groetzinger 107 S.Ct 980 (1987) where the Court held that questions of the legitimacy of a business when reviewed by appellate courts are questions of law not of fact. See p987, 988 Sct.

In the Court below we questioned the statutory notice since no findings with respect to the partnership or the general partner were made in CA #70851. We relied on the 9th Circuit case of Scar v Comm (9th Cir) 814 F2d 1363. There the Court held that in order for a statutory notice to have the force of a presumption there must be an official finding, not a mere accusation. In both cases below, in the case of the movie and oil investments, the statutory did not even identify the general partner. In neither case did the Service introduce any evidence, other than to state the losses, to prove the

general partners motivation or to establish that the investments were illegitimate or a sham.

Under the principles of Frank Lyon and Groetzinger this case should be reviewed and the Service and lower courts advised that more than an accusation must be made to cast more of a burden on a taxpayer than to prove that he invested in what to him reasonably appeared to be a legitimate business.

3. AGREEMENTS BETWEEN TAXPAYERS AND THE INTERNAL REVENUE SERVICE SHOULD BE GOVERNED BY GENERAL CONTRACT LAW PRINCIPLES

Both cases in this petition involve stipulations, in neither did the Tax Court evaluate the testimony of witnesses. The Service did not question that Ravetti had presenile dementia or that he was confined in a mental institution approximately four months before the waiver. There has never been a question of malingering, and the taxpayer should have laid any question to rest by dying of the disease. The Service could have called the Doctor if they had doubt but they did not. They could have introduced the medical records in CA #70852 if they wanted to but they chose not to do so. In CA#70851 they could have challenged our statement that the attorney for the government who drafted the stipulation conceded that collection was allowed in the taxpayers document by mistake. They chose not to do so. They could have challenged our statement in

the Rule 55 motion that the Services stated motivation for collection was to deny administrative expense funds including attorney's fees for this case. They chose not to do so. We submit that their failure was because the fact we allege are true.

This Court has recognized the principle of mistake in contract law since the 1879 case of First National Bank v Hall. Flynn V U. S. supra recognizes that parol evidence is admissible to prove that a waiver of restrictions on assessments is invalid, and is in direct conflict with this case. The Court there applied general contract law, this Court should accept review, and reestablish the principle that Internal Revenue has no greater rights than private litigants do in agreements with taxpayers during either the administrative process or in cases in the courts. It is also possible that the Court might want to suggest that the Internal Revenue Service as representative of the Sovereign might be held to an even higher standard in agreements with the nation's citizens.

CONCLUSION

The Ninth Circuit's depravation of judicial review should not be allowed to stand. Nor should the attribution of profit motivation to the general partner which is being made by the lower courts before Congressional authorization. Still less should the Court allow seizure of taxpayer assets in cases in the Tax Court to give the Internal Revenue an edge in

the conflict.

This case as it stands represents in its published version an abandonment to the Internal Revenue Service the field of domestic relations. In its unpublished version, in a practical sense, it abandons the field of sham losses to the agency. The loss deduction for trade or businesses authorized by Congress will be at the mercy of the Service. This case is an extreme one, and the administration of the tax law will be aided by the Court restating that the basic right to fair treatment and constitutional procedure applies even in tax cases.

Dated: February 7, 1995

Respectfully Submitted,

Richard H. Foster